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No. 193

Supreme Court of the United States

OCTOBER TERM, 1949

PALM BEACH TRUST COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT and BRIEF IN SUPPORT THEREOF.

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Supreme Court of the United States

OCTOBER TERM, 1949

No. .

PALM BEACH TRUST COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT.

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

The petitioner, Palm Beach Trust Company, (1) respectfully prays that a Writ of Certiorari issue to the United States Court of Appeals for the District of Columbia Circuit to review that part of the judgment of the Court of Appeals entered April 18, 1949 (R. 40, 41), which affirmed the decision of The Tax Court of the United States (R. 26a) to the extent that it determined that the petitioner was not a trust company for the calendar year 1941, but a personal holding company liable to a deficiency in the personal holding company surtax liability for that year in the amount of $5,491.57, and (2) respectfully shows to this Honorable Court:

I.

A summary and short statement of the matter involved.

This case involves the petitioner's personal holding company surtax liability for the calendar year 1941 (hereinafter referred to as "1941"). It is the position of the petitioner that it was a bona fide trust company during 1941, clearly meeting every requirement of a trust company laid down by section 104(a) of the Internal Revenue Code (hereinafter referred to as the Code), and hence, by virtue of Code section 501(b), was not a personal holding company liable to such surtax. However, the United States Court of Appeals for the District of Columbia Circuit affirmed (R. 39-41) a decision of The Tax Court of the United States (R. 26a) holding the petitioner liable to personal holding company surtax. Since the affirmance was expressly based (R. 39) upon the opinion of the Tax Court, that opinion (R. 19a-22a) for the purposes of this petition and to the extent it was adopted by the affirmance, is treated as the opinion and holding of the Court of Appeals.

The relevant facts, all stipulated, are simply stated as follows:

The petitioner filed its corporation income and declared value excess-profits tax return for 1941 with the Collector of Internal Revenue for the District of Florida. The petitioner did not file a personal holding company return for the calendar year 1941. The petitioner's books of account have always been kept on the cash receipts and disbursements basis. (R. 12a, 13a.)

The petitioner was incorporated on May 25, 1929, as a trust company under the laws of the State of Florida, with all the rights, powers, and privileges granted and conferred by the trust laws of that state regulating the organization, powers, and management of trust companies, except those powers relating to title insurance and receiving money on deposit subject to check. (R. 13a.)

The petitioner's capital stock consisted of 1,000 shares of the par value of $100 per share, for which the subscribers paid $150 per share. The capital stock of the petitioner was owned during 1941, as follows:

Name of Stockholder	*Number of Shares Owned*
John S. Phipps, President of petitioner	175
Henry C. Phipps, Vice-President of petitioner	200
Howard Phipps, Vice-President of petitioner	200
David T. Layman, Jr., Secretary and Treasurer of petitioner	15
R. C. Alley	10
Henry B. Martin Trust	50
Towsend B. Martin Trust	50
Esmond B. Martin Trust	50
Alastair B. Martin Trust	50
Amy Guest	200
Total	1,000 (R. 13a.)

A certificate of authority to commence the business of a trust company was granted to the petitioner by the Comptroller of the State of Florida under date of September 22, 1930. The certificate states:

It being expressly understood that this certificate of authority does not extend to a general banking business, neither does it include the acceptance of trust business from individuals, partnerships and corporations other than those who may be stockholders of the company. (R. 13a, 14a.)

This certificate of authority was replaced by an amended certificate of authority under date of March 2, 1937, which provided that "the Palm Beach Trust Company of Palm Beach in the County of Palm Beach and the State of Florida, is authorized to commence the business of a Trust Company (without title insurance powers) under the name

above given with a capital stock of one hundred thousand dollars. It being expressly understood that this amended Certificate of Authority does not extend to a general banking business, as provided for in Paragraph 17, of Section 6126, Compiled General Laws of Florida." (R. 14a.)

During 1941 the petitioner was subjected to supervision and examination by the authority of the State of Florida having supervision over banking institutions. In reply to an inquiry from the State Auditor, the petitioner on January 4, 1941, advised that as of December 31, 1940, it had deposited $50,000 face amount of Palm Beach County bonds and $50,000 cash with the State Treasurer; and that the deposit represented at least 25 per cent of its paid-in capital. The Comptroller's office of the State of Florida made examinations of the petitioner as of the close of business June 30, 1941, and December 13, 1941. Formal reports thereon were filed. (R. 14a.)

During the years 1937 to 1944, inclusive, the petitioner declared itself trustee and acted as trustee of various mortgages on Florida real estate for the benefit of various holders of trust certificates. The declarations of trust were evidenced by written trust agreements and trust certificates executed by the petitioner. It was generally provided in the trust agreements that "The reasonable fees and expenses of the trustee shall be paid pro-rata by the owners of the certificates of beneficial interest herein and the amount thereof may be withheld and applied to payment thereof from any moneys or property collected or received by it in the performance of its functions hereunder." (R. 14a, 21a (footnote).)

The petitioner maintained a journal and a ledger in which it recorded the transactions relating to the mortgages of which it had declared itself trustee. (R. 15a.)

The petitioner regularly prepared and transmitted to

the mortgagors bills for interest and principal as the same became due with respect to the mortgages. The unpaid principal with respect to the mortgages as of January 1, 1941, amounted to approximately $300,000. (R. 15a.)

During 1941 the petitioner made approximately 50 collections aggregating approximately $90,000 on account of principal and interest with respect to the mortgages, and remitted these collections promptly to the beneficiaries named in the trust instruments, but rendered no bill and received no income for these services. Its officers received no salary in 1941, and the petitioner did not receive any deposits from the general public. (R. 15a.)

The beneficiaries of the trusts which the petitioner administered during 1941 were for the most part children and grandchildren of two of the petitioner's principal stockholders. Approximately 13 per cent of the mortgages which the petitioner held in trust was held for Henry C. Phipps, Amy Guest, and Molly Phipps (wife of Michael G. Phipps, who is the son of John S. Phipps), and the balance of the mortgages which the petitioner held in trust was held for Bessemer Trust Company, which trust company was trustee for the following named individuals:

John E. Phipps (grandson of John S. Phipps)
Margaret Douglas (daughter of John S. Phipps)
Michael G. Phipps (son of John S. Phipps)
Hubert B. Phipps (son of John S. Phipps)
Molly Phipps (wife of Michael G. Phipps, who is the son of John S. Phipps)
Sonia Phipps Farrell (daughter of Henry C. Phipps)
Dita Gordon Douglas (granddaughter of John S. Phipps)
Audrey Phipps Holden (daughter of Henry C. Phipps)
Barbara Phipps Janney (daughter of Henry C. Phipps)

(R. 15a, 16a.)

John S. Phipps, Henry C. Phipps, and Howard Phipps were the principal organizers of the petitioner. They were the owners of more than 50 per cent of the stock. They were the controlling members of the board of directors and were the president and vice-presidents, respectively, of the petitioner. The petitioner in 1941 had made no disposition of its income since its organization and had paid no dividends. (R. 16a.)

II.

A statement particularly disclosing the basis upon which it is contended that the Supreme Court of the United States has jurisdiction to review the judgment of the United States Court of Appeals for the District of Columbia Circuit.

(a) The statutory provision believed to sustain the jurisdiction of the Supreme Court of the United States.

The Supreme Court of the United States has jurisdiction to review the judgment of the United States Court of Appeals for the District of Columbia Circuit by reason of the provisions of section 1254, Title 28, of the United States Code (Chapter 646, Public Law 773, 80th Congress, Second Session). (Appendix, p. 28, *infra*.)

(b) The date of the judgment sought to be reviewed and the date upon which the Petition for Writ of Certiorari is presented.

The date of the judgment sought to be reviewed is April 18, 1949 (R. 40, 41); the date upon which the Petition for Writ of Certiorari is presented is July 15, 1949.

III.

The question presented.

The question presented is: Was the petitioner during 1941 a trust company, meeting the requirements laid down by Code section 104(a)?[1] This is the question presented reduced to its narrowest form. If the petitioner was such a trust company, then it was necessarily a "bank" as that term is defined in Code section 104(a)[1] and as such did not, under Code section 501(b)[2], classify as a personal holding company liable to personal holding company surtax under Code section 500. (Appendix, p. 27, *infra.*)

IV.

The reasons relied on for the allowance of the writ.

The United States Court of Appeals for the District of Columbia Circuit in the instant case in determining that the petitioner was not a trust company but a personal holding company liable to a personal holding company surtax deficiency for 1941 (1) has erroneously decided an important question of Federal law which has not been, but should be, settled by the Supreme Court of the United States; (2) has rendered a decision in conflict with the decisions of the United States Courts of Appeals in:

Pembroke Realty and Securities Corporation v. *Commissioner,* 122 F. (2d) 252 (C. A. 2nd, 1941),

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(1) "SEC. 104. Banks and Trust Companies.

(a) DEFINITION.—As used in this section the term 'bank' means a bank or *trust company incorporated and doing business under the laws* of the United States (including laws relating to the District of Columbia), *of any State,* or of any Territory, *a substantial part of the business of which consists* of receiving deposits and making loans and discounts, or *of exercising fiduciary powers similar to those permitted to national banks* under section 11(k) of the Federal Reserve Act, 38 Stat. 262 (U. S. C., Title 12, § 248k), as amended, *and which is subject by law to supervision and examination by State,* Territorial or Federal *authority having supervision over banking institutions.*" (Italics supplied.)

(2) "SEC. 501. Definition of Personal Holding Company.

* * * *

(b) EXCEPTIONS.—The term 'personal holding company' does not include * * * a bank as defined in section 104."

* * * *

Knight Newspapers, Inc., v. *Commissioner*, 143 F. (2d) 1007 (C. A. 6th, 1944),
Helvering v. *Rebsamen Motors, Inc.*, 128 F. (2d) 584 (C. A. 8th, 1942),
Crooks, Collector of Internal Revenue, v. *Kansas City Hay Dealers' Ass'n*, 37 F. (2d) 83 (C. A. 8th, 1929), and
A-C Investment Association v. *Helvering*, 68 F. (2d) 386 (C. A. D. C., 1933);

and (3) has decided a Federal question in a way probably in conflict with the decision of the Supreme Court of the United States in *United States* v. *Cambridge Loan and Building Company*, 278 U. S. 55 (1928).

(1)

During 1941 the petitioner was a trust company (admittedly incorporated under Florida law and supervised by the banking authorities of that State) engaged solely in fiduciary activities for its stockholders, their descendants, and their families. (R. 20a, 21a.) It was precluded by its certificate of authority from engaging in a banking business. (R. 14a.) While the opinion below (R. 19a-22a) is vague and illogical and talks about issue being joined by the parties on whether a substantial part of the petitioner's business consisted of exercising fiduciary powers similar to those permitted to national banks (R. 20a), analysis of the opinion indicates that the basic ground upon which the petitioner's classification as a trust company is denied is that its fiduciary activities were restricted and informal, i.e., the petitioner was a restricted and intimate family venture carrying on business for a small group and not for the public generally. (R. 21a.) But the Code prescribes no such limitation for qualification as a trust company.

The denial by the Court of Appeals of the petitioner's classification as a trust company on this ground (R. 39)

presents an important question of Federal law which has not been, but should be, finally settled by the Supreme Court of the United States. Specifically, that question is whether, in construing the provisions of the Code exempting specified organizations from the penal provisions of the personal holding company surtax, it is permissible to go beyond the plain and ordinary meaning of the language of the statute and to impute thereto limitations having no support in the statutory language. As stated by Judge Johnson of the Tax Court in his dissenting opinion (R. 24a, 25a):

> "These reasons [for denying petitioner's classification as a trust company], in my opinion, impute to the quoted sections limitations which Congress did not enact and which a court may not judicially add."

The Court of Appeals and the Tax Court have violated the fundamental rule that, with the exception noted in the next paragraph, clear and unambiguous language in a taxing statute, particularly where a penalty is involved, must be construed according to its ordinary meaning, upon which meaning taxpayers should be entitled to rely in determining their tax liability and arranging their business affairs.

The only recognized or permissible exception to this rule is in the case of a sham transaction or in the case of an organization or corporation having no legitimate business purpose (e. g., see *Gregory* v. *Helvering*, 293 U. S. 465 (1935)). That exception does not apply here, for, as pointed out in the *per curiam* opinion of the Court of Appeals, "Petitioner company was originally organized prior to the imposition of the personal holding company surtax, and it had an original business purpose quite apart from tax considerations." (R. 39.) It is to be noted that the petitioner was incorporated in Florida in 1929 to carry on a limited trust company business in that State with a capital of

$100,000 and a paid-in surplus of $50,000. Both amounts were the minimum permitted by Florida law. Florida Statutes Annotated, Title 36, section 655.01. (Appendix, p. 28, *infra.*) Not only was no more capital or paid-in surplus invested by the petitioner's stockholders than was necessary to comply with the State law, but also neither the petitioner's capital nor its paid-in surplus has ever been increased. (R. 32a. Exh. 1-A, lines 14-15 of Schedule L on page 4.) The personal holding company surtax was first imposed in 1934 by section 351 of the Revenue Act of 1934. Manifestly, therefore, the organization of the petitioner in 1929 was not motivated in any respect by personal holding company surtax considerations.

The decision of the Court of Appeals has the effect in the case of all private trust companies, of which there are many in the United States, of casting a serious doubt upon their status as bona fide trust companies for Federal income tax purposes. If the decision in the instant case is not reviewed, private trust companies, mutual savings banks, and other like organizations must necessarily continue in the dark as to their true income tax status, and will be under a serious handicap in making their business plans. Such situation is a matter of general interest and should be clarified by this Court.

(2)

The decision of the Court of Appeals is in conflict with a number of decisions of the United States Courts of Appeals for various Circuits as follows:

The Second Circuit in *Pembroke Realty and Securities Corporation* v. *Commissioner,* 122 F. (2d) 252 (1941), held that for personal holding company surtax purposes the distribution by a corporation of current earnings should be deemed a deductible dividend, regardless of the fact that a prior impairment of the corporation's capital

technically prevented the corporation from having an accumulation of earnings and profits from which ordinary dividends could be paid.

In *Knight Newspapers, Inc.*, v. *Commissioner*, 143 F. (2d) 1007 (1944), where it appeared that a dividend was received by a personal holding company in the taxable year under a claim of right and without restriction as to its disposition, but the dividend was rescinded and repaid in a later year because of a mistake of fact by the payor corporation in the prior year, the Sixth Circuit held that, for personal holding company surtax purposes, the receipt of the dividend gave rise to a constructive trust and not to taxable income, it appearing that a ruling to the contrary would result in unusual hardship and injustice to the taxpayer company. The Sixth Circuit pointed out (p. 1010):

> "The cases cited, however, deal with the incidence of the general income tax***. Here, however, a surtax of some 65 to 75% is involved***. The personal holding company surtax is not, it is urged, a true tax, but a penalty."

In *Helvering* v. *Rebsamen Motors, Inc.*, 128 F. (2d) 584 (1942), the Eighth Circuit held that the words "gains from sale of stock" in the statutory definition of a personal holding company did not include gain derived upon the liquidation of a subsidiary. Observing that the personal holding company surtax was "in the nature of a penalty," the Court stated (p. 587):

> "* * * It is not unreasonable to believe that Congress, in defining a 'personal holding company,' spoke with precision and did not intend that corporations which fell outside of the definition of § 351(b)(1)(A), *when read literally*, should be subjected to the surtax." (Italics supplied.)

The decisions in the *Pembroke, Knight,* and *Rebsamen* cases, frankly recognizing, as they do, that the personal

holding company surtax is highly penal, and that the statutory provisions relating to its imposition are to be strictly construed in favor of the taxpayer, are the antithesis of the decision of the Court of Appeals in the instant case.

In *Crooks, Collector of Internal Revenue,* v. *Kansas City Hay Dealers' Ass'n,* 37 F. (2d) 83 (1929), the Eighth Circuit held that the statutory provisions granting income tax exemption from the ordinary, non-penal income tax must be construed in accordance with the plain and ordinary meaning of the language used. The question there presented was whether a voluntary association of 50 to 60 men, which employed men to inspect cars of hay bought and sold by members of the association, was exempt as a business league not organized for profit, and no part of the net earnings of which inured to the benefit of any private shareholder or individual. In holding the association exempt, a contention that Congress, in exempting business leagues, did not intend to exempt organizations which did not serve the public generally (similar to the contention adopted by the Court of Appeals in the instant case), was rejected, the opinion stated (p. 84):

> "Appellant contends that appellee is a sort of guild or brotherhood existing entirely for the benefit of its membership and in no way for the benefit of the public, and that Congress intended to exempt only such organizations as were devoted entirely to the general public welfare. Congress did not so say."

In *A-C Investment Association* v. *Helvering,* 68 F. (2d) 386 (1933), the District of Columbia Circuit, in passing upon the question whether a particular organization was exempt from the ordinary, non-penal income tax as a "mutual savings bank not having a capital stock represented by shares," stated (p. 390):

"But it is argued on behalf of the Commissioner that, because it is not an organization for public use—in other words, because it has a private rather than a public character—it cannot be denominated a bank, and therefore is something else not within the exemption of the statute. The basis of this is that petitioner's facilities are not open to the accommodation of the general public, that its banking quarters are located in conjunction or proximity with the offices of the cotton company, and its members limited to the employees of a single corporation and its subsidiaries and affiliates. Because of this it is insisted it was not intended by Congress to exempt it from the payment of the tax; but the argument is not convincing. It cannot be claimed it was intended by Congress to exclude from the privileges of the exemption a savings bank organized by, and confined to, farmers, or to farmers of a particular locality, or to persons engaged in a particular line of business. There is no restriction as to personnel or membership. There is nothing in the language of the statute to indicate such a purpose, and the statute is broad enough to include all organizations, corporate or private, local or general, sectarian or nonsectarian, agricultural or business, which embrace and are restricted to the attributes of a mutual savings institution."

(3)

The Court of Appeals has in the instant case decided a Federal question in a way probably in conflict with the decision of the Supreme Court of the United States in *United States* v. *Cambridge Loan and Building Company*, 278 U. S. 55 (1928), in which the question presented was whether a certain organization was exempt from ordinary income tax as a domestic building and loan association. In holding that it was exempt, the Supreme Court of the United States construed the term "domestic building and loan association" in accordance with the plain and ordinary

meaning of the term, and refused to read into the term limitations which were not specified by the taxing statute. The Court stated (p. 59):

> "* * * The statutes speak of 'domestic' associations, that is, associations sanctioned by the several States. They must be taken to accept, with the qualifications expressly stated, what the States are content to recognize, unless there is a gross misuse of the name. The State of Ohio has recognized and still recognizes the respondent as belonging to the class which its name indicates. Very possibly the company has strained its privileges to near the limit, but we are not prepared to condemn the nomenclature adopted by the State."

WHEREFORE, the petitioner prays that a Writ of Certiorari be issued out of and under the seal of this Honorable Court directed to the United States Court of Appeals for the District of Columbia Circuit, commanding that Court to certify and to send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket, "No. 9865, *Palm Beach Trust Company, Petitioner,* v. *Commissioner of Internal Revenue, Respondent,*" to the end that the said case may be reviewed and determined by this Honorable Court according to law; and that the petitioner may have such other and further relief in the premises as to this Honorable Court may seem proper and in conformity with law.

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July, 1949.

PETITIONER'S BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

Opinions Below.

The opinion of the United States Court of Appeals for the District of Columbia Circuit is reported in *Palm Beach Trust Company* v. *Commissioner of Internal Revenue,* — F. (2d) — (C. A. D. C., 1949) (R. 39, 40); and the opinion of The Tax Court of the United States is reported in *Palm Beach Trust Company,* 9 T. C. 1060 (1947) (R. 12a-24a).

Jurisdiction.

The grounds on which the jurisdiction of the Supreme Court of the United States is invoked are set forth in the Petition for Writ of Certiorari (p. 6, *supra*).

Statement of the Case.

The relevant facts and the question presented are as set forth in the Petition for Writ of Certiorari (pp. 2-6 and p. 7, respectively, *supra*).

Specifications of Error.

1. The United States Court of Appeals for the District of Columbia Circuit erred in holding that the petitioner was during 1941 a personal holding company as defined in section 501 of the Internal Revenue Code (hereinafter referred to as the Code).

2. The United States Court of Appeals for the District of Columbia Circuit erred in failing to hold that the petitioner was during 1941 a trust company meeting the requirements laid down by Code section 104, and hence excludible from personal holding company classification.

3. The United States Court of Appeals for the District of Columbia Circuit erred in holding that the petitioner's acting as trustee for the owners of certificates of beneficial

interest covering mortgages on Florida real estate held by it as trustee, including its conduct of mortgage operations, was not a substantial part of its business.

4. The United States Court of Appeals for the District of Columbia Circuit erred in holding that the petitioner was not a trust company meeting the requirements laid down by Code section 104, because its fiduciary activities were restricted and informal and an intimate family venture not carried on with the public generally.

5. The United States Court of Appeals for the District of Columbia Circuit erred in holding that the petitioner, because it did not receive deposits, was not within the scope of the policy which caused Congress to exclude trust companies from personal holding company classification.

Summary of Argument.

The petitioner (1) was incorporated as a trust company under the laws of the State of Florida, (2) was, pursuant to authorization by the State Comptroller, engaged wholly in the business of acting as trustee of a large number of mortgages on Florida real estate, and engaged in no extraneous activities, and (3) was during that year subject to supervision and examination by the authority of the State of Florida having supervision over banking institutions. The facts that the petitioner did not conduct business with the public generally, that it did not collect its trustee's fees currently, and that it did not accept deposits for the protection of the depositors of which it built up a surplus, are immaterial. The petitioner, incorporated with a minimum capital and surplus five years before a personal holding company surtax was first imposed, was neither organized nor utilized as a device for tax avoidance. Accordingly, the petitioner was during 1941, a bona fide trust company meeting the requirements laid down by Code section 104(a), and as such was expressly excluded by Code section 501(b) from classification and taxation as a personal holding company.

Argument.

During 1941 the petitioner was a trust company meeting the requirements laid down by Code Section 104(a) and as such did not, under Code Section 501(b), classify as a personal holding company subject to personal holding company surtax under Code Section 500.

By virtue of Code section 501(b), a personal holding company does not include a bank, as defined in Code section 104(a). A bank is defined in Code section 104(a) to mean either:

> A. A bank (i) incorporated and doing business under the laws of any State, (ii) a substantial part of the business of which consists of receiving deposits and making loans and discounts, (iii) which is subject by law to supervision and examination by State authority having supervision over banking institutions, or
>
> B. A trust company (i) incorporated and doing business under the laws of any State, (ii) a substantial part of the business of which consists of exercising fiduciary powers similar to those permitted to national banks under section 11(k) of the Federal Reserve Act, as amended, (iii) which is subject by law to supervision and examination by State authority having supervision over banking institutions.

The fact that the Internal Revenue Code in both sections 104(a) and 501(b) uses the term "bank" as including a trust company but in section 104(a) intermingles the special Code requirements of a bank with those of a trust company, has obviously confused the Court of Appeals and the Tax Court, with the result that they have failed to distin-

guish between the Code requirements of a bank and those of a trust company. To guard against confusion, the issue presented is most precisely stated (avoiding the use of the word "bank") as follows: Was the petitioner during 1941 *a trust company* meeting the trust company requirements laid down by Code section 104(a)?

It is conceded by the Court of Appeals and the Tax Court, first, that the petitioner was incorporated in 1929 *as a trust company* under the laws of Florida and was invested generally by those laws with the rights, powers, and privileges of a trust company (requirement B(i), *supra*), and, second, that during 1941 the petitioner was subject by law to supervision and examination by the banking authorities of Florida (requirement B(iii), *supra*). (R. 13a, 14a, 20a.) Accordingly, there is presented for consideration only the question whether during 1941 the remaining statutory requirement of a trust company was met, i.e., that a substantial part of the business of the petitioner consisted of "exercising fiduciary powers similar to those permitted to national banks" (requirement B(ii), *supra*).

A trust company need not undertake fiduciary activities for the public generally.

The Court of Appeals and the Tax Court held that, since the petitioner's activities in the fiduciary field during 1941 consisted of acting as trustee (of 15 mortgages on Florida real estate totaling $300,000, upon which 50 collections aggregating $90,000 were made and paid out) not for the public generally, but for the benefit of two of the petitioner's principal officers and stockholders, their descendants, and their families, such restricted activities did not constitute a substantial part of its business. (R. 21a.) This is manifestly a complete *non sequitur* and a clear error of law. The fact is, as the record demonstrates, that the petitioner engaged in no activities except those above referred to (other, of course, than incidentally collecting interest

and dividends on, and making some protective sales of, securities representing its capital and surplus), and hence the petitioner's fiduciary activities constituted not only a substantial part of its business but all of its business. (R. 15a, 30a.) This conclusion, based on logic and common sense as contrasted to the *non sequitur* indulged in by the Court of Appeals and the Tax Court, finds support in the record from at least two further angles:

1. It is well established that the test of whether a corporation is engaged in business is whether it is performing the functions for which it was organized. *Edwards* v. *Chile Copper Co.*, 270 U. S. 452 (1926). By that test the petitioner was unquestionably engaged in the business of performing its fiduciary activities as a trustee. Furthermore, by asserting against the petitioner over the years capital stock taxes and their companion taxes, declared value excess-profits taxes (which would be payable only if the petitioner was engaged in business), the respondent has repeatedly indicated his agreements in that test. (R. 32a, Exh. 1-A, line 44 on page 1 and lines 1-8 on page 2.)

2. The petitioner under date of September 22, 1930, received a certificate of authority from the Comptroller of Florida "to commence the business of a trust company," *not including* a general banking business or *any trust business for persons other than stockholders of the company.* (R. 13a, 14a). Thus, it is manifest that the banking authorities of Florida had no doubt on the proposition that acting as trustee exclusively for stockholders constituted carrying on trust company business under Florida law. The category of those for whom the petitioner could do a trust company business (expressly excluding, however, insurance or a general banking business) was broadened by an amended certificate of authority

granted by the Comptroller of Florida under date of March 2, 1937, so as to remove the restriction limiting its trust business solely to stockholders. (R. 14a, 28a.) It was under this amended certificate that the petitioner was enabled to carry on its trust company business during 1941 with others than its stockholders.

As those familiar with its legislative history know, and as unbiased consideration of the matter will convincingly indicate, the purpose of Congress in including in Code section 104(a) and its predecessor sections[3] the requirements that a substantial part of the business of a bank must consist of receiving deposits and making loans and discounts, and that a substantial part of the business of a trust company must consist of exercising fiduciary powers similar to those permitted to national banks, was to assure that banks and trust companies (deriving their powers from various special statutes of the numerous States and Territories, as to which statutes the Federal Government had no say) would not be enabled, solely by virtue of the nomenclature of those statutes and based upon some nominal banking or trust company function undertaken, to engage in businesses largely extraneous to the banking or trust company business, and yet be entitled to

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(3) Section 351 of the Revenue Act of 1934 (c. 277, section 351, 48 Stat. 751; 26 U. S. C. A., Internal Revenue Acts, p. 757), which first imposed a special surtax on personal holding companies, excludes from personal holding company classification "a bank or trust company incorporated under the laws of the United States or of any State or Territory, a substantial part of whose business is the receipt of deposits * * *."

In the Revenue Act of 1936 (c. 690, section 104, 49 Stat. 1677; 26 U. S. C. A., Internal Revenue Acts, p. 854), this provision was expanded and incorporated in section 104(a), so as to read:

> "(a) DEFINITION.—As used in this section the term 'bank' means a bank or trust company incorporated and doing business under the laws of the United States (including laws relating to the District of Columbia), of any State, or of any Territory, *a substantial part of the business of which consists* of receiving deposits and making loans and discounts, or *of exercising fiduciary powers similar to those permitted to national banks under section 11(k) of the Federal Reserve Act, as amended*, and which is subject by law to supervision and examination by State or Federal authority having supervision over banking institutions." (Italics supplied.)

be treated as legitimate banks and trust companies for Federal tax purposes. Congress wisely legislated against that obvious possibility by requiring in the predecessor sections of Code section 104(a) that a substantial part of the business of a bank or trust company, recognized as such for Federal tax purposes, must be banking or trust company business as ordinarily understood. Therefore, if, upon consideration of all of the multifarious activities of a corporation claiming to be a bank or trust company under Code section 104(a), it appears that a substantial part of its activities does not fall within the usual concept of banking or trust company business, the corporation is not entitled to classification as a bank or trust company. Congress was liberal in providing for such cases, since it did not require that the banking or trust company business engaged in must predominate, but merely that it must be substantial. Thus, it allowed considerable leeway for banks and trust companies to engage in various extraneous activities. The petitioner, however, has never asserted this right in any degree.

Trust company business means what the term commonly implies, i. e., acting as trustee or in any other fiduciary capacity in which trust companies generally act. To maintain, however, that a trust company must engage in all of the possible diversified, variegated activities permissible to trust companies before it will be considered to be a trust company, is as unreasonable as saying that a lawyer will not be considered to be a lawyer unless he engages simultaneously in all branches of law.

Section 104(a) of the Revenue Act of 1936 (c. 690, section 104, 49 Stat. 1677; 26 U.S.C.A., Internal Revenue Acts, p. 854) was the first revenue statute to provide as a special requirement to trust company classification that a substantial part of a trust company's business must consist of exercising fiduciary powers similar to those permitted to national banks under section 11(k) of the Federal

Reserve Act, as amended. Section 11(k) grants to national banks, when not in contravention of State or local law, the right to act as trustee, executor, administrator, registrar of stocks and bonds, guardian of estates, assignee, receiver, committee of estates of lunatics, *or in any other fiduciary capacity* in which trust companies or other corporations which come into competition with national banks are permitted to act under State laws. The Court of Appeals and the Tax Court apparently conclude by reason of this lengthy enumeration of fiduciary activities that a trust company, to be recognized as such for Federal tax purposes, must engage in the whole gamut of specified activities. This is a patently erroneous conclusion. The enumeration of fiduciary activities in section 11(k) is in the disjunctive and not in the conjunctive, closing with the language "*or* in any other fiduciary capacity." In passing upon applications of national banks to exercise the powers enumerated in section 11(k), the Federal Reserve Board is by that section given the right to take into consideration the amount of capital and surplus of the applying bank, whether or not such capital and surplus is sufficient under the circumstances of the case, the needs of the community to be served, and any other facts and circumstances that seem proper. In other words, the Federal Reserve Board may refuse permission to a national bank to carry on fiduciary activities in a State, if it decides that the needs of the local community will not be served by granting such permission. This authority granted to the Federal Reserve Board by section (k) does not affect in any way a trust company organized under State law or the requirements for qualification under Code section 104(a). When Florida trust companies are involved, it is the Comptroller of Florida who decides whether trust business can be done and the scope thereof, and, as has been pointed out, in 1930 he granted the petitioner a certificate of authority prohibiting the acceptance

of trust business except from the stockholders of the petitioner.

Whether Code section 104(a) is construed literally or in the light of its legislative history, the petitioner's qualification thereunder as a trust company cannot be validly questioned. Its only business activity was that of a trust company, *i. e.*, acting as trustee of various mortgages on Florida real estate, a fiduciary activity permitted to national banks under section 11(k) of the Federal Reserve Act, as amended. (R. 20a, 21a, 29a-31a.) It engaged in no extraneous activities whatever. The logical way to determine whether a substantial part of the petitioner's business consisted of exercising fiduciary powers is first to consider all of its activities, and then to separate the activities which consisted of exercising fiduciary powers from the remainder of the activities. This approach to the problem demonstrates that all of the petitioner's business (and that includes a substantial part with something to spare) consisted of exercising fiduciary powers similar to those permitted to national banks. Nevertheless, by some amazing logic the Court of Appeals and the Tax Court concluded that the petitioner's fiduciary activities in 1941 did not constitute a substantial part of its business, at the same time recognizing that the petitioner did not engage in a single activity not typical of ordinary trust company business. (R. 20a, 21a.) By what process of reasoning the Court of Appeals and the Tax Court reached the conclusion that a substantial part of the petitioner's business did not consist of exercising fiduciary powers is entirely incomprehensible.

The petitioner did not perform its fiduciary services gratuitously.

The Court of Appeals and the Tax Court intimate, but do *not* hold, that the petitioner performed services without making a charge. This intimation is based wholly upon

the fortuitous and entirely ordinary circumstance that during 1941 the petitioner "rendered no bill and received no income for these [fiduciary] services." (R. 15a.) The reasonable value for such services rendered in 1941 was approximately $2,250[4], the collectibility of which was beyond doubt. It was certainly not at all unusual that the petitioner did not render a bill for its 1941 services prior to the close of the year, it being a matter of general knowledge that trustees often, if not generally, defer billing for, and collecting, compensation for services until long after their rendition. Under Florida law trustees' compensation is allowable upon equitable principles, even in the absence of specific provisions therefor in the trust agreements.[5] The instant case, however, is an *a fortiori* case, since the trust instruments themselves stipulated for reasonable trustee's fees. (R. 21a, footnote 2.)

Fallacious reasoning of the Court of Appeals and the Tax Court.

The Court of Appeals and the Tax Court fell into gross error in their attempt to show by legislative history why Congress excluded trust companies from personal holding company classification. It says (R. 22a) that the Congressional reason for the exclusion was to enable trust companies as well as banks to build up surplus rserves out of earnings for the safety and protection of their depositors as a matter of wise public policy, whereas no such public purpose would be served in the instant case. It is obvious

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(4) This figure is obtained by applying the standard annual charge made by Florida trust companies of ¼ of one per cent to the $300,000 principal of the trusts as of January 1, 1941.

(5) Thus, in *Rhoades* v. *Frazier*, 124 Fla. 737, 169 So. 379 (1936), the Court stated:

> "We have no statute providing for or fixing the amount of trustees' compensation. * * * upon equitable principles a reasonable compensation should be allowed to trustees for their services, and the care and responsibility incident to their position."

that the Court of Appeals and the Tax Court completely overlooked the very obvious distinction between banks and trust companies. Even though the reason of Congress for excluding banks engaged in receiving deposits and making loans and discounts from personal holding company classification was to enable such banks to build up a surplus for the protection of depositors, certainly beyond any question of a doubt such could not have been the reason of Congress for excluding from personal holding company classification trust companies not engaged in receiving deposits but rather in the exercising of fiduciary powers similar to those permitted to national banks. (See footnote on p. 20, *supra*.) It may well be that in the last analysis the confusion of the Court of Appeals and the Tax Court on this point accounts for their refusing to hold that the petitioner was a trust company excluded from personal holding company classification, since significantly the opinion below closes its discussion of the issue involved with the remark: "No such public purpose [of permitting the surplus of banks to be built up for the protection of depositors] is present on these facts, and the conclusion seems to be required that petitioner, not being a bank [or a trust company] within the meaning of the defining section, was during the period in issue a personal holding company." (R. 22a.)

The basic error of the Court of Appeals and the Tax Court is the premise that a trust company must carry on business with the public generally or be subjected to the penal personal holding company surtax. That premise is not warranted by the provisions of Code section 104(a); it disregards the common practice of organizing trust companies to operate for restricted classes of customers (e. g., the Savings Banks Trust Company chartered under the banking laws of the State of New York, the trust business of which is limited to services performed for mutual savings

banks in New York which are stockholders of the company; see Moody's, Banks—Insurance, Real Estate—Investment Trusts (1948 ed.), p. 140); and it is not recognized as one of the requirements of a trust company by the respondent's Regulations (Treasury Regulations 103, Sec. 19.104-1). It is significant that those same Regulations, in passing upon the status of mutual savings banks which are granted exemption from all Federal income taxes, should take pains to point out that a mutual savings bank need not serve the public in general in order to be exempt but may confine its business to a designated class of individuals. (Treasury Regulations 103, Sec. 19.101(2)-1.) To the same effect is *A-C Investment Association* v. *Helvering,* 68 Fed. (2d) 386 (C. A. D. C., 1933). Unusual indeed is the fact that in passing upon the status of a trust company which is subject to Federal income taxes, but excluded from the classification of corporations subject to the penal personal holding company surtax, the respondent should completely reverse his position in the instant case and contend that serving the public generally is a *sine qua non* to being recognized as a trust company.

Conclusion.

It is respectfully submitted that the Petition for Writ of Certiorari should be granted as prayed for.

Respectfully submitted,

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July, 1949.

APPENDIX.

atutes and Regulations Involved (as applicable to 1941).

Relevant provisions of the Internal Revenue Code, S. C., Title 26, are as follows:

"SEC. 500. SURTAX ON PERSONAL HOLDING COMPANIES.

There shall be levied, collected, and paid, for each taxable year beginning after December 31, 1938, upon the undistributed subchapter A net income of every personal holding company (in addition to the taxes imposed by chapter 1) a surtax equal to the sum of the following:

(1) 71½ per centum of the amount thereof not in excess of $2,000; plus

(2) 82½ per centum of the amount thereof in excess of $2,000."

"SEC. 501. DEFINITION OF PERSONAL HOLDING COMPANY.

* * * *

(b) *Exceptions.*—The term 'personal holding company' does not include * * * a bank as defined in section 104."

"SEC. 104. BANKS AND TRUST COMPANIES.

(a) *Definition.*—As used in this section the term 'bank' means a bank or trust company incorporated and doing business under the laws of the United States (including laws relating to the District of Columbia), of any State, or of any Territory, a substantial part of the business of which consists of receiving deposits and making loans and discounts, or of exercising fiduciary powers similar to those permitted to national banks under section 11(k) of the Federal Reserve Act, 38 Stat. 262 (U. S. C., Title 12, § 248k), as amended, and which is subject by law to supervision and examination by State, Territorial or Federal authority having supervision over banking institutions."

Other Relevant Statutes and Regulations are as follows:

Federal Reserve Act, section 11; 38 Stat. 262; U. S. C., Title 12, § 248:

> "*Enumerated powers.*
>
> The Board of Governors of the Federal Reserve System shall be authorized and empowered:
>
> • • • • •
>
> (k) To grant by special permit to national banks applying therefor, when not in contravention of State or local law, the right to act as trustee, executor, administrator, registrar of stocks and bonds, guardian of estates, assignee, receiver, committee of estates of lunatics, or in any other fiduciary capacity in which State banks, trust companies, or other corporations which come into competition with national banks are permitted to act under the laws of the State in which the national bank is located.
>
> • • • • •"

Florida Statutes Annotated, Title 36, § 655.01:

> "• • • the capital stock of any trust company hereafter organized under the terms of this article shall not be less than one hundred thousand dollars, and shall be divided into shares of one hundred dollars each, all of which, together with a paid in surplus of not less than fifty thousand dollars shall be paid in cash before any such trust company shall be authorized to transact any other business than such as relates to its formation and organization, and such payment shall be certified to the comptroller of the State of Florida, under oath by the president and treasurer or secretary of the trust company • • •."

Judiciary and Judicial Procedure, U. S. C., Title 28, § 1254:

> "*Courts of appeals; certiorari; appeal; certified questions*
>
> Cases in the courts of appeals may be reviewed by the Supreme Court by the following methods:

(1) By writ of certiorari granted upon the petition of any party to any civil or criminal case, before or after rendition of judgment or decree;

(2) By appeal by a party relying on a State statute held by a court of appeals to be invalid as repugnant to the Constitution, treaties or laws of the United States, but such appeal shall preclude review by writ of certiorari at the instance of such appellant, and the review on appeal shall be restricted to the Federal questions presented;

(3) By certification at any time by a court of appeals of any question of law in any civil or criminal case as to which instructions are desired, and upon such certification the Supreme Court may give binding instructions or require the entire record to be sent up for decision of the entire matter in controversy."

Treasury Regulations 103, Sec. 19.101(2)-1:

"*Mutual savings banks.*—In order that a corporation may be entitled to exemption as a mutual savings bank, it must appear that it is an organization—

(1) Which has no capital stock represented by shares, and

(2) Whose earnings, less only the expenses of operation, are distributable wholly among the depositors.

If it appears that the organization has shareholders who participate in the profits, the organization will not be exempt.

A mutual savings bank need not be incorporated or be under public supervision, unless, in either case a State statute so requires, nor need it serve the public in general, in order to be exempt. It may confine its business to a designated class of individuals, such as employees of a single corporation, without losing its exempt status."

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In the Supreme Court of the United States

OCTOBER TERM, 1949

No. 193

PALM BEACH TRUST COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 12-25) is reported in 9 T. C. 1060. The opinion of the Court of Appeals (R. 39-40) is reported in 174 F. 2d 527.

JURISDICTION

The judgment of the Court of Appeals was entered on April 18, 1949. (R. 40-41.) The petition for a writ of certiorari was filed on July 15, 1949. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTION PRESENTED

Whether the court below erred in affirming the decision of the Tax Court that the taxpayer was a "personal holding company" during the taxable year 1941 within the meaning of Section 501 (a) of the Internal Revenue Code and not a "bank" as defined in Section 104 (a) of the Code, exempt from classification as a personal holding company under Section 501 (b) of the Code.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the statutes and Regulations are printed in the Appendix, *infra*, pp. 15-20.

STATEMENT

The pertinent facts (including exhibits) were stipulated (R. 26-33) and were adopted by reference and found by the Tax Court accordingly (R. 12-16), as follows:[1]

The taxpayer filed its corporation income and declared value excess profits tax return for 1941 with the Collector of Internal Revenue for the District of Florida. It did not file a personal holding company return for the calendar year 1941. Its books of account have always been kept on the cash receipts and disbursements basis. (R. 12-13.)

The taxpayer was incorporated on May 25, 1929, as a trust company under the laws of the State of

[1] Other facts found by the Tax Court in respect of other issues (R. 16-19) decided in favor of the taxpayer by the Tax Court (R. 22-23), or by the court below (R. 39-40), have been omitted from the statement of facts here.

Florida, with all the rights, powers, and privileges granted and conferred by the trust laws of that State regulating the organization, powers, and management of trust companies, except those powers relating to title insurance and receiving money on deposit subject to check. (R. 13.)

The taxpayer's capital stock consisted of 1,000 shares of the par value of $100 per share, for which the subscribers paid $150 per share. The capital stock of the taxpayer was owned during 1941, as follows (R. 13):

Stockholder	*Shares owned*
John S. Phipps, president of petitioner	175
Henry C. Phipps, vice president of petitioner	200
Howard Phipps, vice president of petitioner	200
David T. Layman, Jr., secretary and treasurer of petitioner	15
R. C. Alley	10
Henry B. Martin trust	50
Townsend B. Martin trust	50
Esmond B. Martin trust	50
Alastair B. Martin trust	50
Amy Guest	200
Total	1,000

A certificate of authority to commence the business of a trust company was granted to the taxpayer by the Comptroller of the State of Florida under

date of September 22, 1930. (R. 13.) The certificate states (R. 14):

> *It being expressly understood that this certificate of authority does not extend to a general banking business, neither does it include the acceptance of trust business from individuals, partnerships and corporations other than those who may be stockholders of the company.*

This certificate of authority was replaced by an amended certificate of authority under date of March 2, 1937, which provided (R. 14) that—

> the Palm Beach Trust Company of Palm Beach in the County of Palm Beach and the State of Florida, is authorized to commence the business of a trust company (without title insurance powers) under the name above given with a capital stock of one hundred thousand dollars. It being expressly understood that this amended Certificate of Authority does not extend to a general banking business, as provided for in Paragraph 17, of Section 6126, Compiled General Laws of Florida.

During 1941, the taxpayer was subjected to supervision and examination by the authority of the State of Florida having supervision over banking institutions. In reply to an inquiry from the state auditor, the taxpayer on January 4, 1941, advised that as of December 31, 1940, it had deposited $50,000 face amount of Palm Beach County bonds and $50,000 cash with the state treasurer; and that the deposit represented 25% of its paid-in capital.

The office of the Comptroller of the State of Florida made examinations of the taxpayer as of the close of business June 30, 1941, and December 13, 1941. Formal reports thereon were filed. (R. 14.)

During the years 1937 to 1944, inclusive, the taxpayer declared itself trustee and acted as trustee of various mortgages on Florida real estate for the benefit of various holders of trust certificates. The declarations of trust were evidenced by written trust agreements and trust certificates executed by the taxpayer. (R. 14.)

The taxpayer maintained a journal and a ledger in which it recorded the transactions relating to the mortgages of which it had declared itself trustee. (R. 15.)

The taxpayer regularly prepared and transmitted to the mortgagors bills for interest and principal as the same became due with respect to the mortgages. The unpaid principal with respect to the mortgages as of January 1, 1941, amounted to approximately $300,000. (R. 15.)

During 1941, the taxpayer made approximately 50 collections aggregating approximately $90,000 on account of principal and interest with respect to the mortgages, and remitted these collections promptly to the beneficiaries named in the trust instruments, but rendered no bill and received no income for these services. Its officers received no salary in 1941 and the taxpayer did not receive any deposits from the general public. (R. 15.)

The beneficiaries of the trusts which the taxpayer administered during 1941 were for the most part children and grandchildren of two of the taxpayer's principal stockholders. Approximately 13% of the mortgages which the taxpayer held in trust was held for Henry C. Phipps, Amy Guest, and Molly Phipps (wife of Michael G. Phipps, who is the son of John S. Phipps), and the remaining mortgages which the taxpayer held in trust were held for the Bessemer Trust Company, which trust company was trustee for the following named individuals (R. 15-16):

John E. Phipps (grandson of John S. Phipps)
Margaret Douglas (daughter of John S. Phipps)
Michael G. Phipps (son of John S. Phipps)
Hubert B. Phipps (son of John S. Phipps)
Molly Phipps (wife of Michael G. Phipps, who is the son of John S. Phipps)
Sonia Phipps Farrell (daughter of Henry C. Phipps)
Dita Gordon Douglas (granddaughter of John S. Phipps)
Audrey Phipps Holden (daughter of Henry C. Phipps)
Barbara Phipps Janney (daughter of Henry C. Phipps)

John S. Phipps, Henry C. Phipps, and Howard Phipps were the principal organizers of the taxpayer. They were the owners of more than 50% of the stock. They were the controlling members of the board of directors and were the president

and vice presidents, respectively, of the taxpayer. The taxpayer in 1941 had made no disposition of its income since its organization and had paid no dividends. (R. 16.)

The income of the taxpayer in the year 1941 was derived from the following sources (R. 16):

Interest on loans, notes, mortgages, bonds, bank deposits, etc.....	$2,058.75
Gains on sales of securities, including gain on sale of Miami 2 per cent certificates (hereinafter mentioned)	12,534.70
Dividends	618.75
Total	15,212.20

The taxpayer was a "personal holding company" in 1941 and not a "bank." (R. 16.)

Upon the basis of these facts, the Tax Court, affirming the Commissioner's determination in respect of the issue involved here (R. 6-8), held that the taxpayer was not exempt as a "bank" from the personal holding company status[2] (R. 19-22), and the court below affirmed (R. 39-40).

ARGUMENT

1. The issue is whether the taxpayer was exempt in 1941 from classification and taxation as a personal holding company under Section 501 (b) of the Internal Revenue Code because it was a "bank"

[2] The Tax Court also held that the taxpayer was liable for the 25% penalty under Section 291 of the Internal Revenue Code (26 U.S.C. 1946 ed., Sec. 291) for failure to have filed a personal holding company tax return for 1941 (R. 23-24), but the court below reversed (R. 39-40), and the Government did not file a petition for a writ of certiorari.

as defined in Section 104 (a) (Appendix, *infra*, p. 15), it being conceded that the taxpayer otherwise meets the conditions for classification as a personal holding company set out in Sections 501, 502 and 503 (Appendix, *infra*, pp. 16-18). To qualify for the exemption, the taxpayer must have shown that a substantial part of its business consisted of exercising fiduciary powers similar to those permitted to national banks under Section 11 (k) of the Federal Reserve Act[3] (Appendix, *infra*, pp. 18-19).

We submit that both lower courts correctly held that the taxpayer's "business" did not include the fiduciary powers exercised by it in 1941. It was stipulated that the taxpayer received no income for the performance of fiduciary services in 1941 (R. 30) and the Tax Court's conclusion was warranted, if not compelled, that it performed them without the expectation of profit (R. 20-21).[4] The

[3] The taxpayer was incorporated and acted as a trust company with limited authority under the laws of Florida and was supervised and examined in 1941 by the state officer having supervision over banking institutions (R. 14), as required by Section 104 (a) for classification as a "bank". Whether the taxpayer was also "doing business" under the laws of Florida within the meaning of Section 104 (a) is not clear, but it was unnecessary to consider this point in the lower courts, since in any case the taxpayer's exercise of fiduciary powers was not a "business" activity.

[4] The taxpayer argues (Pet. 23-24) that it did not perform fiduciary services gratuitously. The stipulation of facts (R. 30) shows that at the time of the hearing on March 31, 1947 (R. 10), the taxpayer had rendered no bill for its services and had received nothing for the performance of such services. Clearly the inference is required that it performed the services in 1941 without charge.

activities thus do not qualify as "business." *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, 171; *Chaloner* v. *Helvering*, 69 F. 2d 571, 572 (C. A. D. C.); cf. *Higgins* v. *Commissioner*, 312 U. S. 212, 217. It follows that the taxpayer's fiduciary activities were not a substantial part of its business; indeed they were no part of its business.[5] This consideration alone denies classification as a "bank" to the taxpayer.

Moreover, the taxpayer exercised its trust powers exclusively for the benefit of members of the Phipps family which controlled it, and not for the public, or a class thereof, generally, as a true bank or trust company would do. That Section 104 (a) contemplates something more than a family corporation performing fiduciary services for members of the family without charge is shown by its reference to Section 11 (k) of the Federal Reserve Act as a standard. That section deals with enumerated broad fiduciary powers which may be granted to national banks upon a showing of sufficient financial ability and other relevant factors so that "the needs of the community to be served" may be assured. Quite plainly the concept there is of a banking corporation which will exercise fiduciary powers for the public, or a class thereof, generally, rather than gratuitously for members of its controlling family only. Since the taxpayer per-

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[5] Petitioner's reliance (Pet. 19) on *Edwards* v. *Chile Copper Co.*, 270 U. S. 452, is misplaced, for the corporation there "was organized for profit and was doing what it principally was organized to do in order to realize profit." 270 U. S. at 455.

formed only limited fiduciary services without charge for members of its controlling family, it quite clearly was not a trust company within the meaning of Section 104 (a). Cf. *Jenkins* v. *Neff*, 163 N. Y. 320, 330; *People* v. *National Security Co.*, 177 N. Y. S. 838, 839; *Perpetual Executors and Trustees Association of Australia* v. *Swan*, L. R. A. C. (1898) 763, 764; 3 Bouvier's Law Dictionary (1914) 3333.

The purpose for which Sections 104 and 501 (b) were enacted confirms that this taxpayer, which is only a family corporation rendering services for the family, is not to be exempted from the personal holding company surtax as a "bank." The exemption granted by Sections 104 (b) and 501 (b) to banks and trust companies from all but the normal tax and surtax imposed by Sections 13, 14 and 15 of the Internal Revenue Code (26 U. S. C. 1946 ed., Secs. 13, 14 and 15) is obviously to insulate them from the heavy surtaxes imposed on corporations improperly accumulating surplus (Section 102 of the Internal Revenue Code (26 U. S. C. 1946 ed., Sec. 102)), and on the undistributed earnings of personal holding companies. Because banks and trust companies are often required to retain their earnings, rather than to distribute them, the exemption was afforded for the protection of their depositors. See H. Rep. No. 2475, 74th Cong., 2d Sess., p. 9 (1939-1 Cum. Bull. (Part 2) 667, 673); S. Rep. No. 2156, 74th Cong., 2d Sess., pp. 13-14

(1939-1 Cum. Bull. (Part 2) 678, 686); *Staunton Industrial L. Corp.* v. *Commissioner,* 120 F. 2d 930, 933 (C. A. 4th)—all dealing with Section 104 as originally enacted in the Revenue Act of 1936, c. 690, 49 Stat. 1648.[6] Cf. Section 351 (b)(1) of the Revenue Act of 1934, c. 277, 48 Stat. 680, which excluded from the term "personal holding company" "a bank or trust company incorporated under the laws of the United States or of any State or Territory, a substantial part of whose business is the receipt of deposits." With this purpose in mind, it is obvious that Congress would hardly have intended to include within the exemption a purely private family corporation, which acted as a fiduciary only for its controlling stockholders and members of their families, since no such considerations of public policy are involved. This seems particularly true, because other family corporations or associations performing the same fiduciary functions but not incorporated as a "trust company" under state law would be subject to the

[6] Sections 104 and 501 (b) originally appeared as Sections 104 and 351 (b), respectively, of the Revenue Act of 1936. That Act also enacted the controversial surtax on undistributed profits of corporations generally which was later abandoned. The principal object of Section 104 in that Act was to exempt banks from this tax. Under Section 104 (b) as it existed in 1941, a bank is liable for the ordinary surtax imposed on corporations by Section 15 of the Code (26 U.S.C. 1946 ed., Sec. 15), and the principal effect of Section 104 then is to exempt banks from the Section 102 surtax on improper accumulation of surplus. Section 501 (b) performs the same function as to personal holding company surtax. The original purpose of Congress in enacting Sections 104 and 501 (b) of course still remains.

personal holding company surtax. The mere fact, stressed by the taxpayer (Pet. 18), that it was classified as a trust company under state law, does not determine its status for purposes of Section 104 (a), which has its own additional criteria.

There is no merit to the taxpayer's argument (Pet. 21-22) that the lower courts construed the statute to mean that a trust company must actually engage in all the fiduciary activities specified by Section 11 (k) of the Federal Reserve Act, in order to be classed as a "bank". That was not the basis of the decision. The Tax Court's reasoning, concurred in by the Court of Appeals, was not that the taxpayer's fiduciary activities were not of sufficient variety, but that exemption should be denied because such activities were not carried on for profit and because they were performed only in a restricted and intimate family venture. (R. 21-22.) As already shown, the statutory provisions require that these factors be given effect.

2. The decision in this case is not in conflict with any other decision. Although the taxpayer asserts a conflict with five decisions of various circuits (Pet. 7-8, 10-13) and a probable conflict with *United States* v. *Cambridge Loan & Bldg. Co.*, 278 U. S. 55 (Pet. 8, 13-14), its discussion of these cases demonstrates that the factual situations and the questions presented were different from those in this case, thus removing any possibility of a direct conflict. Indeed, the taxpayer's asserted conflict

with three cases (*Pembroke Realty & S. Corp.* v. *Commissioner,* 122 F. 2d 252 (C. A. 2d); *Knight Newspapers* v. *Commissioner,* 143 F. 2d 1007 (C. A. 6th); and *Helvering* v. *Rebsamen Motors,* 128 F. 2d 584 (C. A. 8th)) rests only on its view that the lower court failed to give effect to the principles that the personal holding company surtax is highly penal, and that the statutory provisions imposing the surtax are to be strictly construed in the taxpayer's favor. (Pet. 11-12.) But the decision here does not disregard these principles.

A-C Inv. Ass'n v. *Helvering,* 68 F. 2d 386 (C. A. D. C.), decided by the same court which decided this case, is distinguishable from the decision here, since it involved a different statute, and different facts. Although in the *A-C Inv. Ass'n* case an association formed to handle and invest the savings of the numerous employees of a large cotton corporation was held to be exempt from all taxation as a mutual savings bank, despite the fact that it was a private, rather than a public, banking association, the controlling statute in that case (Section 231 (2) of the Revenue Acts of 1921 (c. 136, 42 Stat. 227), 1924 (c. 234, 43 Stat. 253) and 1926 (c. 27, 44 Stat. 9)), unlike the one here, exempted "Mutual savings banks not having a capital stock represented by shares" with no further limitations. Further, that case differs from the present case in that there the association operated for profit, its average earnings being about 7% (p. 387), and it was consistent

with the purpose underlying the exemption statute, namely, to stimulate savings and thrift (p. 390), to treat the association as a mutual savings bank.

3. Since the judgment in this case is correct and is not in conflict with any other decision, the case does not require further review by this Court. For the reason that the decision turns on the particular facts of this case, we believe that the taxpayer's statement as to its possible importance in relation to private investment companies generally (Pet. 10) is considerably magnified.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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AUGUST, 1949.

APPENDIX

Internal Revenue Code:

SEC. 104. BANKS AND TRUST COMPANIES.

(a) *Definition.*—As used in this section the term "bank" means a bank or trust company incorporated and doing business under the laws of the United States (including laws relating to the District of Columbia), of any State, or of any Territory, a substantial part of the business of which consists of receiving deposits and making loans and discounts, or of exercising fiduciary powers similar to those permitted to national banks under section 11 (k) of the Federal Reserve Act, 38 Stat. 262 (U. S. C., Title 12, Sec. 248k), as amended, and which is subject by law to supervision and examination by State, Territorial or Federal authority having supervision over banking institutions.

(b) [As amended by Sec. 104 (c) of the Revenue Act of 1941, c. 412, 55 Stat. 687] *Rate of Tax.*—Banks shall be subject to tax under section 13 or section 14 (b), and under section 15.

(26 U. S. C. 1946 ed., Sec. 104.)

SEC. 500 [As amended by Sec. 110 (a) of the Revenue Act of 1941, *supra*]. SURTAX ON PERSONAL HOLDING COMPANIES.

There shall be levied, collected, and paid, for each taxable year beginning after December 31, 1938, upon the undistributed subchapter A net income of every personal holding com-

pany (in addition to the taxes imposed by chapter 1), a surtax equal to the sum of the following:

(1) 71½ per centum of the amount thereof not in excess of $2,000; plus

(2) 82½ per centum of the amount thereof in excess of $2,000.

(26 U. S. C. 1946 ed., Sec. 500.)

SEC. 501. DEFINITION OF PERSONAL HOLDING COMPANY.

(a) *General Rule.*—For the purposes of this subchapter and chapter 1, the term "personal holding company" means any corporation if—

(1) *Gross income requirement.*—At least 80 per centum of its gross income for the taxable year is personal holding company income as defined in section 502; but if the corporation is a personal holding company with respect to any taxable year beginning after December 31, 1936, then, for each subsequent taxable year, the minimum percentage shall be 70 per centum in lieu of 80 per centum, until a taxable year during the whole of the last half of which the stock ownership required by paragraph (2) does not exist, or until the expiration of three consecutive taxable years in each of which less than 70 per centum of the gross income is personal holding company income; and

(2) *Stock ownership requirement.*—At any time during the last half of the taxable

year more than 50 per centum in value of its outstanding stock is owned, directly or indirectly, by or for not more than five individuals.

(b) *Exceptions.*—The term "personal holding company" does not include a corporation exempt from taxation under section 101, a bank as defined in section 104 * * *.

* * * *

(26 U. S. C. 1946 ed., Sec. 501.)

SEC. 502. PERSONAL HOLDING COMPANY INCOME.

For the purposes of this subchapter the term "personal holding company income" means the portion of the gross income which consists of:

(a) Dividends, interest (other than interest constituting rent as defined in subsection (g)), royalties (other than mineral, oil, or gas royalties), annuities.

(b) *Stock and Securities Transactions.*—Except in the case of regular dealers in stock or securities, gains from the sale or exchange of stock or securities.

* * * *

(26 U. S. C. 1946 ed., Sec. 502.)

SEC. 503. STOCK OWNERSHIP.

(a) *Constructive Ownership.*—For the purpose of determining whether a corporation is a personal holding company, insofar as such

determination is based on stock ownership under section 501 (a) (2), section 502 (e), or section 502 (f)—

(1) *Stock not owned by individual*—Stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust shall be considered as being owned proportionately by its shareholders, partners, or beneficiaries.

(2) *Family and partnership ownership.*—An individual shall be considered as owning the stock owned, directly or indirectly, by or for his family or by or for his partner. For the purposes of this paragraph the family of an individual includes only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants.

* * * *

(26 U. S. C. 1946 ed., Sec. 503.)

Federal Reserve Act of December 23, 1913, c. 6, 38 Stat. 251:

SEC. 11. The Federal Reserve Board shall be authorized and empowered:

* * * *

(k) [As amended and reenacted by Sec. 2 of the Act of September 26, 1918, c. 177, 40 Stat. 967, 968, 969.] To grant by special permit to national banks applying therefor, when not in contravention of State or local law, the right to act as trustee, executor, administrator, registrar of stocks and bonds, guardian of estates,

assignee, receiver, committee of estates of lunatics, or in any other fiduciary capacity in which State banks, trust companies, or other corporations which come into competition with national banks are permitted to act under the laws of the State in which the national bank is located.

* * * *

In passing upon applications for permission to exercise the powers enumerated in this subsection, the Federal Reserve Board may take into consideration the amount of capital and surplus of the applying bank, whether or not such capital and surplus is sufficient under the circumstances of the case, the needs of the community to be served, and any other facts and circumstances that seem to it proper, and may grant or refuse the application accordingly: * * *.

* * * *

(12 U. S. C. 1946 ed., Sec. 248.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.502-1. *Personal holding company income.*—The term "personal holding company income" means the portion of the gross income which consists of the following:

* * * *

(5) *Gains from the sale or exchange of stock or securities.*—The term "gains from the sale or exchange of stock or securities" as used

in section 502 (b) applies to all gains * * * from the sale or exchange of stock or securities includible in gross income. The term "stock or securities" as used in section 502 (b) includes shares or certificates of stock, or * * * bonds, debentures, certificates of indebtedness, notes, car trust certificates, bills of exchange, obligations issued by or on behalf of a Government, State, Territory, or political subdivision thereof. * * *

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